

HAWAII ADMINISTRATIVE RULES

TITLE 16

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

CHAPTER 27

SUPERVISORY AND ENFORCEMENT ACTION  
RELATING TO FINANCIAL INSTITUTIONS

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## SUBCHAPTER 1

### GENERAL PROVISIONS

§16-27-1 Objectives. The objectives of this chapter are to assure that supervisory and enforcement actions are directed to financial institutions whose condition warrants greater regulatory oversight, and to assure uniformity of such actions by the division of financial institutions. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

§16-27-2 Definitions. As used in this chapter:

"Commissioner" means the commissioner of financial institutions, the official responsible for licensing, examining, and supervising state-chartered financial institutions.

"Division" means the division of financial institutions, department of commerce and consumer affairs, State of Hawaii.

"Financial institution" or "institution" means a state-chartered financial institution including a bank, foreign bank representative office or agency, trust company, savings and loan association, industrial loan company, or credit union.

"UFIRS" (Uniform Financial Institutions Rating System) means the policy statement which was issued and recommended by the Federal Financial Institutions Examination Council on November 21, 1979, and adopted by the division, pursuant to section 16-26-7. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

## SUBCHAPTER 2

### BASIS FOR SUPERVISORY AND ENFORCEMENT ACTION

§16-27-8 Authorized actions by commissioner. (a) The commissioner has broad supervisory and enforcement powers under section 401-5, HRS, and other state laws. The commissioner has the power to direct a financial institution to discontinue any violation of law or rule, or any unsafe or unsound practice, or to cease the conduct of its business in an unsafe or unsound manner. Failure or refusal to comply with the commissioner's order shall be deemed a violation of law.

(b) If a financial institution fails to comply with the commissioner's order, the commissioner may exercise such supervision, control, and management

over the institution as the commissioner deems necessary for the public welfare, including, but not limited to, the appointment of a receiver.

(c) Supervisory or enforcement action shall be taken on financial institutions which have been assigned a UFIRS composite rating of "3", "4", or "5", unless circumstances do not warrant the use of such supervisory tools. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 401-12, 402-5, 403-161, 406-51, 407-102, 408-25, 410-35, 410-35.5, 410-36)

§16-27-9 Unsafe or unsound practice. (a) The concept of an unsafe or unsound practice is one of general application which touches upon the entire field of operations of a financial institution.

An unsafe or unsound practice encompasses any action or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would result in abnormal risk of loss or damage to an institution, its depositors, or its shareholders. An activity not necessarily unsafe or unsound in every instance may be so in a particular instance when considered in light of all relevant facts pertaining to that situation.

(b) An unsafe or unsound practice can result from either action or inaction by management. Although the law does not define the term unsafe or unsound practice, the division has established examples of such practices, some of which are listed below.

(c) Inaction by management which is deemed an unsafe or unsound practice includes, but is not limited to:

- (1) Failure to provide adequate supervision and direction over officers of the institution;
- (2) Failure to make provision for an adequate reserve for possible loan losses;
- (3) Failure to post the general ledger promptly;
- (4) Failure to keep accurate books and records;
- (5) Failure to enforce programs for repayment of loans; or
- (6) Failure to obtain or maintain on the premises evidence of priority of liens on loans secured by real estate.

(d) Action by management which is deemed an unsafe or unsound practice includes, but is not limited to:

- (1) Operating with an inadequate level of capital for the kind and quality of assets held;
- (2) Engaging in hazardous lending or lax collection practices such as: extending credit which is inadequately secured, extending credit without first obtaining complete and current financial information,

extending credit in the form of overdrafts without adequate controls, and extending credit with inadequate diversification of risk;

- (3) Operating without adequate liquidity, in light of the institution's asset and liability mix;
- (4) Operating without adequate internal controls such as: failing to maintain controls on official checks and unissued certificates of deposits, failing to segregate duties of institution personnel, and failing to reconcile differences in correspondent bank accounts;
- (5) Engaging in speculative or hazardous investment policies; or
- (6) Paying excessive dividends in relation to the institution's capital position, earnings capacity, and asset quality. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

§16-27-10 Unsafe or unsound condition. (a) An unsafe or unsound condition of an institution depends upon an analysis of virtually every aspect of the institution's operation. The institution's capital position, asset condition, management, earnings posture, and liquidity position shall be carefully evaluated. An institution's condition need not deteriorate to a point where it is on the brink of insolvency before its condition may be found to be unsafe or unsound.

(b) Although not an all inclusive list, the following are examples of unsafe or unsound conditions:

- (1) Maintenance of unduly low net interest margins;
- (2) Excessive overhead expenses;
- (3) Excessive volume of loans subject to adverse classification;
- (4) Excessive net loan losses;
- (5) Excessive volume of overdue loans;
- (6) Excessive volume of nonearning assets; or
- (7) Excessive large liability dependence. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

### SUBCHAPTER 3

#### INFORMAL SUPERVISORY AND ENFORCEMENT ACTION

§16-27-16 Memorandum of understanding. (a) Informal action by means of a memorandum of understanding shall be considered for financial institutions

which have been assigned a UFIRS composite "3" rating. The memorandum of understanding is a means of applying informal administrative action to financial institutions considered to be of supervisory concern, but which have not deteriorated to the point where they warrant formal administrative action. The purpose of the memorandum is to correct an institution's weaknesses by focusing on the institution's problem areas and defining responsibility for ensuring that deficiencies are addressed within designated time periods.

(b) The memorandum of understanding shall be signed by the commissioner and the financial institution's board of directors. In all instances, the respective federal authority shall be invited to join in this action.

(c) The memorandum of understanding shall address the specific problems of an individual institution. Use of the memorandum, as opposed to formal supervisory and enforcement action, is appropriate where the problems discussed with management and the board of directors of the institution have been adequately detailed and the institution, in good faith, will work to eliminate the problems. Notwithstanding its lack of legal enforceability, an institution's failure to comply with the provisions of the memorandum, or continued deterioration in the areas addressed in the memorandum, may facilitate implementation of formal administrative action.

(d) Monitoring of an outstanding memorandum of understanding may be conducted by the division through progress reports, visitations, or examinations.

(e) Termination of a memorandum of understanding shall be considered when the institution's overall condition has improved significantly and the institution has substantially complied with the terms of the memorandum. The division shall coordinate any termination with the federal authority, if the latter is a party to the action.

(f) General use of a memorandum of understanding for a UFIRS composite "3" rated institution does not preclude recourse to formal supervisory and enforcement action when it is believed that management is unwilling to take necessary corrective action nor does it prohibit use of a memorandum in situations where other than a UFIRS composite "3" rating is assigned.

(g) The memorandum of understanding may be used in a situation where other than a UFIRS composite "3" rating is assigned, depending on the circumstances. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

## SUBCHAPTER 4

### FORMAL SUPERVISORY AND ENFORCEMENT ACTION

§16-27-22 Institutions rated "4" or "5". (a) Financial institutions with UFIRS composite ratings of "4" or "5" by definition will have problems of sufficient severity to warrant formal supervisory and enforcement action. Formal action may be taken against institutions rated "4" or "5", where evidence of an unsafe or unsound practice or condition is present. The formal action may consist of a cease and desist order, or order to suspend or remove a director or officer of the institution.

(b) The commissioner may consider not taking formal action when the condition of the institution reflects significant improvement resulting from an effective corrective program or where individual circumstances strongly mitigate the appropriateness of the action. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

§16-27-23 Cease and desist order. (a) Where an institution is engaging in or about to engage in an unsafe or unsound practice or violation of law or rule, the commissioner may order the institution to cease and desist from such practice and require that affirmative steps be taken to correct the conditions resulting therefrom. The commissioner shall issue and serve a notice of charges upon the institution in cases:

- (1) Where the institution is engaging, or has engaged, in an unsafe or unsound practice or condition;
- (2) Where the institution is violating, or has violated, a law, rule, order, or any condition imposed in writing by the commissioner with regard to the approval of a request or application, or a written agreement entered into with the commissioner; or
- (3) Where there is reasonable cause to believe the institution is about to engage in either of the above actions.

(b) The notice of charges shall contain a statement of facts relating to the practice or violation and set forth a time and place for hearing to determine whether a cease and desist order shall be issued. Notification shall also be made to the appropriate federal regulatory agency.

(c) To institute this enforcement proceeding, the commissioner has the burden of proving formal charges set out in a notice of charges. The reports of any examination or the testimony of any examiner will constitute the bulk of evidence upon which the commissioner may rely to sustain the validity of the charges.

(d) Any hearing under this section shall be held pursuant to the provisions of the chapter 91, HRS. Failure of the institution to appear at the hearing is deemed as consent to the issuance of the cease and desist order. The hearing shall be presided over by the commissioner or a hearings officer designated by the commissioner.

(e) The institution may be represented by counsel who has the right to cross-examine the division's witnesses and present evidence in rebuttal or in mitigation of the division's charges.

(f) If the commissioner deems a proceeding confidential, then all pleadings and documents filed in the matter, including the notice of charges, shall be held confidential. Any confidential document shall be made available only to the parties to the proceeding, their legal representatives, or other parties as may be specifically authorized to examine said documents by the commissioner or the hearings officer.

The only persons who may be present during a confidential hearing are parties named in the action, parties determined by the commissioner or the hearings officer to have a direct interest equivalent to judicial standing in the subject matter of the hearing, the legal representatives of the parties, or persons employed by or acting on behalf of the division, the commissioner, hearings officer, or any witness testifying during the proceeding.

(g) A cease and desist order shall be issued after the hearing, if one is held. The order shall become effective after it is served upon the institution. It remains in effect until modified or terminated by the commissioner, or stayed or set aside by a reviewing court. The order may be issued against the institution or any director, officer, employee, agent, or other person participating in the conduct of the affairs of the institution.

(h) The periods for compliance with the various provisions of the cease and desist order are determined based on the circumstances and may include different periods ranging from thirty days to twelve months or more, from the effective date of the order. A cease and desist order may specify intervals setting forth the form and manner of compliance with the substantive requirements of the order.

(i) A visitation may be made as a cross-check on the accuracy of the institution's progress reports and its degree of compliance with the cease and desist order. Examinations of the institution may also be conducted to determine compliance with the order and may be scheduled to coincide with one of the specific corrective periods stated in the order.

(j) The failure of an institution to comply with a cease and desist order may be grounds for subsequent revocation of the institution's charter or receivership action. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

§16-27-24

§16-27-24 Consent cease and desist order. (a) In an effort to eliminate the need for time-consuming administrative hearings, the commissioner may also use the consent cease and desist order procedure. The procedure is premised upon agreement to a stipulation between the commissioner and the institution's board of directors whereby the institution agrees to the issuance of a consent cease and desist order without admitting or denying that an unsafe or unsound practice or condition, or violation of law or rule has occurred.

(b) The effect of this procedure is to reduce the time period between initial review of the case and the date on which an enforceable cease and desist order is issued. The commissioner may obtain the concurrence of the appropriate federal regulatory agency concerning the order.

(c) The stipulation shall provide for waiver by the institution of its rights to a hearing and its consent to immediate issuance of the consent cease and desist order. After finalization of the stipulation, the commissioner shall issue the order. If a satisfactory stipulation cannot be agreed upon, the commissioner shall give notice of the time and place for a cease and desist proceeding. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

§16-27-25 Temporary cease and desist order. (a) In order to act with the utmost speed, the commissioner may issue a temporary cease and desist order, upon a determination that the violation or threatened violation of law or rule or unsafe or unsound practice or condition specified in the notice of charges is likely to cause insolvency or substantial dissipation of assets or earnings of the institution, seriously weaken the condition of the institution, or otherwise seriously prejudice the interests of the depositors during the period in which a cease and desist order or consent cease and desist order can be obtained.

(b) The order, accompanied by a notice of charges, may be issued against the institution or any director, officer, agent, or other person participating in the conduct of the affairs of the institution. The order becomes effective upon service. It remains effective and enforceable, pending completion of the hearing for a cease and desist order or execution of a consent cease and desist order, unless set aside or limited by court proceedings.

(c) Because of the nature of the temporary cease and desist order, the order need not be supported by a completed report of examination. It may be based on a visitation report or other reports addressing the practice, violation, or condition, and its probable effect on the institution. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 410-4)

§16-27-26 Suspension and removal order. (a) The commissioner is authorized to order the removal of any director, officer, or any other person participating in the affairs of an institution, upon determination, after notice and hearing, that:

- (1) The director, officer, or other person has committed any violation of law, rule, or cease and desist order, or has engaged or participated in any unsafe or unsound practice in connection with the institution, or has committed or engaged in any act or omission or practice which constitutes a breach of fiduciary duty of such director or officer; or
- (2) The director, officer, or other person has been charged in any information, indictment, or complaint authorized by a United States attorney, state attorney general, or similar legal officer, with the commission of or participation in a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under state or federal law, and continued service by the individual may pose a threat to the interests of the institution's depositors or may threaten to impair public confidence in the institution; or
- (3) The institution has suffered or will probably suffer substantial financial loss or other damage, or the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty, or the director or officer has received financial gain by reason of the above; and
- (4) The violation, practice, or breach of fiduciary duty is one involving personal dishonesty on the part of the director or officer or one which demonstrates a willful or continuing disregard for the safety and soundness of the institution.

(b) A notice of intention to remove a director, officer, or other person from office shall contain a statement of the facts constituting grounds therefor and designate a time and place for a hearing. Copies of the notice should be served upon the director, officer, associated person, institution, and pertinent federal regulatory agency.

(c) The individual shall be notified of the division's contemplated recommendation for action and offered the option of voluntary suspension.

(d) Should formal action prove necessary, the commissioner shall serve a written notice of the action upon the director, officer, or affiliated person and a copy of the notice upon the institution. The notice will suspend the individual from office and prohibit the individual from further participation in the institution's affairs.

(e) Within thirty days after service of any notice of suspension or order of removal, the person involved may request an opportunity to appear before the commissioner to show that continued service to the institution or participation in its affairs is not likely to pose a threat to the interest of the institution's depositors or threaten to impair public confidence in the institution. The commissioner shall establish a time for a hearing which shall be conducted in conformity with chapter 91, HRS. Within sixty days of such hearing, the party shall be notified of the commissioner's decision as to whether the prohibition or suspension will be continued, terminated, or modified, or whether the order of removal will be rescinded or modified. [Eff 8/13/87] (Auth: HRS §§401-18, 403-7, 406-6, 407-97, 408-33, 410-38) (Imp: HRS §§401-5, 408-32, 410-38, 410-44)

§16-27-27 Suspension or revocation of industrial loan license. (a) The commissioner may suspend or revoke the license of an industrial loan company, based on any of the grounds set forth in section 408-25, HRS, or the following grounds:

- (1) The company has violated a law or rule, or has failed to comply with a formal enforcement order; or
- (2) The company is engaged or participating in an unsafe or unsound practice or is in an unsafe or unsound condition.

(b) The commissioner shall give the industrial loan company notice and an opportunity for a hearing in conformity with chapter 91, HRS. The notice shall be given in writing by registered or certified mail at least twenty days before the hearing, with return receipt requested. A copy of the notice shall be transmitted to the Federal Deposit Insurance Corporation, if the industrial loan company is a member of the Federal Deposit Insurance Corporation.

(c) The commissioner may order the immediate suspension of an industrial loan license for a period not exceeding thirty days, upon a determination that cause for revocation of the license exists and that the circumstances warrant an immediate suspension of the license, pending an investigation. The commissioner shall give the industrial loan company notice and an opportunity for a hearing in conformity with chapter 91, HRS. The notice shall be given in writing by registered or certified mail at least five days before the hearing, with return receipt requested. [Eff 8/13/87] (Auth: HRS §§401-18, 408-33) (Imp: HRS §§401-5, 408-25)

§16-27-28 Suspension or revocation of credit union charter. (a) The commissioner may suspend the operations of a credit union or revoke its charter,

based on any of the grounds set forth in section 410-35.5, HRS. The suspension shall be for a period of at least thirty days, but not more than sixty days.

(b) The commissioner shall give the credit union notice and an opportunity for a hearing in conformity with chapter 91, HRS. The notice shall be given in writing by registered or certified mail at least twenty days before the hearing, with return receipt requested. A copy of the notice shall be transmitted to the National Credit Union Administration. [Eff 8/13/87] (Auth: HRS §410-38) (Imp: HRS §§91-9, 91-9.5, 91-10, 91-11, 91-12, 91-13, 410-35, 410-35.5)

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Chapter 16-27, Hawaii Administrative Rules, on the Summary Page dated July 17, 1987, was adopted on July 17, 1987, following a public hearing held on July 15, 1987, after public notice was given in The Honolulu Advertiser and the Honolulu Star-Bulletin on June 24, 1987.

The adoption of chapter 16-27 shall take effect ten days after filing with the Office of the Lieutenant Governor.

/s/ Donna Tanoue

DONNA TANOUE

Commissioner of Financial Institutions

APPROVED AS TO FORM:      Date 7/24/87

/s/ Winfred K. T. Pong

Deputy Attorney General

APPROVED:      Date 7/24/87

/s/ Robert A. Alm

ROBERT A. ALM

Director of Commerce and Consumer Affairs

APPROVED:      Date 8/3/87

/s/ John Waihee

JOHN WAIHEE, Governor

State of Hawaii

August 3, 1987

Filed

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Adoption of Chapter 16-27  
Hawaii Administrative Rules

July 17, 1987

SUMMARY

Chapter 16-27, Hawaii Administrative Rules, entitled "Supervisory and Enforcement Action Relating to Financial Institutions", is adopted.

THIS MATERIAL CAN BE MADE AVAILABLE FOR INDIVIDUALS WITH SPECIAL NEEDS IN BRAILLE, LARGE PRINT OR AUDIO TAPE. PLEASE SUBMIT YOUR REQUEST TO THE COMMISSIONER OF FINANCIAL INSTITUTIONS AT (808) 586-2820.

DIVISION OF FINANCIAL INSTITUTIONS  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
STATE OF HAWAII

Chapter 16-27, Hawaii Administrative Rules, which was adopted on July 17, 1987 and became effective on August 13, 1987, was the subject of another opportunity to provide public comment. A public hearing was held on September 12, 1989 at 8:00 a.m. in the Kuhina Nui Room, Kamamalu Building, Department of Commerce and Consumer Affairs. Public notice of the hearing was published on August 2, 1989 in The Honolulu Advertiser, Honolulu Star-Bulletin, West Hawaii Today, The Maui News, The Hawaii Tribune-Herald, and the Garden Island.

After review of the comments submitted, the Commissioner of Financial Institutions determined that the rules should remain as originally adopted.

/s/ Clifford K. Higa  
Clifford K. Higa, Commissioner  
Division of Financial Institutions  
Department of Commerce and Consumer Affairs

September 18, 1989  
Date